Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

LLANO, INC.,

Petitioner,

v.

INTERNATIONAL MINERALS AND CHEMICAL CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITION FOR CERTIORARI

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QUESTION PRESENTED

Is a buyer which is obligated either (1) to take gas or (2) to pay a minimum bill relieved of the obligation to pay when it chooses to comply early with a governmental regulation and thereby causes itself not to need the gas but nevertheless requires the seller to stand ready to deliver gas?

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LLANO, INC., *Petitioner,*

v.

INTERNATIONAL MINERALS AND CHEMICAL CORPORATION, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Llano, Inc. (Llano) respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Tenth Circuit entered in this proceeding on August 9, 1985.

QUESTION PRESENTED

Is a buyer which is obligated either (1) to take gas or (2) to pay a minimum bill relieved of the obligation to pay when it chooses to comply early with a governmental regulation and thereby causes itself not to need the gas but nevertheless requires the seller to stand ready to deliver the gas?

OPINION BELOW

The opinion of the court of appeals (not yet reported) is appended hereto as Appendix A. It reverses the judgment of the district court in favor of Llano and remands the case with direction to enter a declaratory judgment in accordance with the opinion of the court of appeals. The order denying rehearing is not reported but is appended hereto as Appendix B. The opinion of the district court (not reported) is appended hereto as Appendix C.

JURISDICTION

The judgment of the United States Court of Appeals for the Tenth Circuit was entered on August 9, 1985. A timely petition by Llano for rehearing was denied on September 18, 1985. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

This is a question of whether basic federal contract law should be contrary to basic state and common contract law; no federal statutes are involved.

STATEMENT OF THE CASE

Llano is a New Mexico corporation engaged in the intrastate transportation and sale of natural gas. International Minerals and Chemical Corporation (IMC) is a New York corporation operating a potash mining facility near Carlsbad, New Mexico. On February 24, 1972, these companies executed a contract (which expired on June 31, 1982) for the delivery of natural gas by Llano to IMC, continuing a transaction begun in 1961. IMC sought a declaratory order in the United States District Court for the District of New Mexico determining its rights and duties under the contract. Llano counterclaimed for damages, alleging that IMC had breached the contract by failing either to purchase the minimum contract volumes or to pay the minimum bill. The district court had jurisdiction by reason of diversity of citizenship between Llano and IMC.

The contract contained a "Minimum Annual Purchase Provision" that required IMC to take a minimum volume of gas from Llano or alternatively to pay a minimum bill. Llano was required to be able each day to deliver to IMC a minimum volume of 4,800 million British Thermal Units of gas. The "Adjustment of Minimum Bill" provision (quoted in App. A at 5) provided that if IMC was unable to take gas for any reason beyond IMC's reasonable control or for any reason based on force majeure, the minimum purchase requirements would be appropriately adjusted. Neither clause excused payment of the minimum bill.

About 60 percent of the gas supplied under the contract was burned in IMC's submerged evaporators as part of a drying process used in the manufacture of chemical fertilizers. This process released particulates into the atmosphere as a by-product. On December 15, 1978, the Environmental Improvement Board of New Mexico (EIB) adopted air quality standards concerning particulate emissions, calling for reduction of emissions to 350 pounds per hour after December 31, 1982, and to 30 pounds per hour after December 31, 1984.

IMC chose to adopt a process that used virtually no natural gas; the district court found that IMC had failed to show other alternatives examined at trial (and which would have utilized natural gas) were unavailable. IMC began testing this process in June 1980. In May and August of 1980, IMC notified Llano that tests would be made and gas consumption reduced for a short time, but never informed Llano that the testing was in response to environmental problems, or that the reduced gas consumption might be permanent because of a "force majeure" situation. IMC rebuffed Llano's attempts to learn what the problem was and would not allow Llano to resolve it by permitting Llano to assign some gas to others. By March 1981, IMC had completely eliminated the submerged evaporators, well in advance of the requirements of the regulations adopted by the EIB.

At all times under the contract, Llano performed its obligation to stand by ready to deliver the full daily contract volumes. The capacity in its system which Llano had allocated for twenty years to serving IMC was never allocated to any other customer. Indeed, if Llano had failed on any day to deliver the volumes

IMC requested, IMC would have had a cause of action against Llano.

REASONS FOR GRANTING THE WRIT

1. The issue in this case will have a profound impact on the natural gas and other energy industries, including local utilities. The court of appeals' decision will create unnecessary uncertainty in these industries.

Minimum take or pay obligations are pervasive in the natural gas industry (from production through distribution and consumption) and form the core of buyers' obligations in contracts involving billions of dollars. These obligations are also common in electricity and coal contracts, although they go by a variety of names. Regardless of the name, their character is the same: the buyer must either (1) purchase some minimum quantity of the commodity or (2) pay some minimum amount if takes of the commodity are deficient. The seller's obligation is to stand by to serve the buyer up to the limit of what the buyer can request.[1]

Decades of custom and usage have sanctioned minimum take or pay obligations. And (until now) the courts have uniformly respected the integrity of these obligations even where *force majeure* has prevented the buyer from taking the commodity.[2] One of the better discussions regarding the nature and enforceability of these obligations is found in *Mobil Oil Corp. v. Tennes-*

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[1] Until recently, federal policy encouraged minimum bills under various names. See *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985). That case provides an excellent discussion of the role of minimum bills for gas pipelines regulated under the Natural Gas Act, 15 U.S.C. § 717 *et seq.* (which Llano is not). In all cases minimum bills, demand charges, take or pay clauses, *etc.*, serve the same function, *i.e.*, they guarantee a minimum level of revenue to the supplier in return for standing ready to serve at any time. For example, any resident of Washington, D.C., will pay a minimum bill for gas and electricity for any one month even if the resident is out of town all month and has turned all appliances off; the local supplier is required to stand by to supply service if the resident returns early and demands service.

[2] Llano has been unable to find any decision (other than the decision below) refusing to enforce such a clause, nor did either the court below or IMC cite such a case.

see Valley Authority, 387 F. Supp. 498 (N.D. Ala. 1974), wherein Mobil had agreed to pay a minimum bill. The court described the contract as follows:

> "Under such a contract, the power supplier agrees to provide a service by making available the customer's contract demand for the contract term. The customer does not agree to use any particular amount of power, but merely to pay a specified sum in exchange for the service — in this case, the minimum bill or [the amount predicated on actual power taken], whichever is higher. The nature of such a contract is well described in [*Gatineau Power Co. v. Fraser Companies, Ltd.* (1941) 20 D.L.R. 487, 496-500, 517 (Brunswick 1940)]:
>
> > 'It seems quite clear to me that under this contract there are mutual obligations. There is an obligation upon the plaintiff to provide the service specified, that is, the maintenance of . . . electrical energy, [some] to be available at all times [and some] under [certain conditions]. Provided that is done by the plaintiff then there is an obligation upon the defendant to pay for such electrical energy at the rate specified, namely, at the rate of $20 per horsepower per year, payable monthly. I do not say that the defendent was bound to take the power, even if available; *the plaintiff was providing a service, the defendant might use the service or not, but if the service were available the defendant was bound to pay for it* [pp. 498-99].'" 387 F. Supp. at 511-12. (Citations omitted.) (Emphasis added.)

Mobil closed down part of its plant and incurred minimum bill charges for three years. The court ruled that TVA was entitled to judgment as a matter of law. The court said Mobil had not breached the contract by reducing its takes of power; Mobil had the option and right to do that. Rather, TVA was suing for amounts accrued under the contract and for which Mobil had bargained.

The court cited and relied[3] on *San Joaquin Light & Power Corp. v. Costaloupes*, 274 P. 84 (Cal. 1929), where the buyer was held liable for the minimum bill even though its plant had been destroyed by fire. In *San Joaquin*, the court relied on *Marin Water & Power Co. v. Town of Sausalito*, 143 P. 767 (Cal. 1914). Both *Mobil* and *San Joaquin* quoted the following from the California Supreme Court's language in *Marin Water*:

> "[T]he contract with which we are here concerned, however, is not the usual agreement to accept and pay for personal property. It is . . . one of that class of agreements in which one of the parties promises to pay a minimum sum for a commodity at a fixed rate, such amount to become due whether enough of the commodity to equal such minimum price at the agreed rate is required or not. Such agreements have been upheld and the minimum rate has been sustained as the true measure of recovery, the promise to pay such sum being a part of the direct obligation of the contract and in no sense a covenant for liquidated damages in case of breach." 274 P. at 86.

In turn, other courts have relied on *Mobil* to reach the same result. *General Cable Corp. v. Citizens Utilities Co.*, 555 P.2d 350, 353 (Ariz. Ct. App. 1976); *Carborundum Co. v. Tennessee Valley Authority*, 521 F. Supp. 590, 594 (S.D. Tenn. 1981).

In *Birdsboro Corp. v. Pennsylvania Public Utility Comm. and UGI Corp.*, 406 A.2d 1184 (Pa. Comm. Ct. 1979), Birdsboro had been buying gas from UGI Corp., the local gas company, under a contract with a minimum bill provision. UGI's pipeline supplier was forced to reduce deliveries to UGI and UGI in turn delivered to Birdsboro less than the minimum bill amount. Nevertheless, Birdsboro was forced to pay. See also *Lone Star Gas Co. v. McCarthy*, 605 S.W.2d 653 (Tex. Civ. App. — Houston — 1st Dist., 1980), where the buyer under a take or pay clause was required to pay the minimum bill despite the facts that (1) the contract permitted buyer to "make up" the deficiency payment by

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[3] See also *Oliver-Mercer Elec. Coop., Inc. v. Fisher*, 146 N.W.2d 346 (N.D. 1966); *Beck v. Indianapolis Light & Power Co.*, 76 N.E. 312 (Ind. App. 1905); *Gould v. Edison Illuminating Co.*, 60 N.Y.S. 559 (Sup. Ct. 1899).

taking gas later without payment and (2) the well depleted before such right could be exercised. See also *Houston Pipe Line Co. v. Oxy Petroleum, Inc.*, 597 S.W.2d 57 (Tex. Civ. App. — Corpus Christi 1980, writ dism'd), and *Olinkraft, Inc. v. Gerend*, 364 So.2d 639 (La. Ct. App. 1978).

The rationale for minimum bills is to impose on the buyer the risks involved in either marketing or consuming the gas. The seller assumes the risk that it can line up an adequate source of supply and be able to make deliveries to the buyer. Competitive conditions, of course, play their role in determining the features of take or pay obligations. In Llano's case, and generally in contracts between pipelines and purchasers, gas supplies must be lined up and plant must be constructed to meet a given level of projected demand. With multiple suppliers and multiple buyers, and with contracts of short or very long duration, the pipeline (or the electricity supplier) bears the risk of overall demand and supply being in equilibrium over time.

The only method by which a pipeline can attempt to equate supply and demand is by lining up purchase and sales contracts that try to equate the two. A take or pay obligation accepted by a buyer nails down, as it were, a certain level of demand. Even if the buyer takes less than the minimum, for whatever reason, revenue will accrue to the seller as if the buyer had taken the minimum, assuring that the seller will recover the sums it bargained for to cover the capital and operating costs of standing ready to serve. The court below, however, has struck a blow against this principal method of risk allocation. If that court's decision is allowed to stand, sellers of natural gas, electricity and coal may find that their contracts are not reliable and that it is the courts, not the parties, that will determine who bears what risks. And such a determination by the courts would be retroactive. That will necessarily change the bargaining process and the costs to ultimate consumers.

The governmental regulation which IMC claims relieved it of its take or pay obligation did not require IMC to be in final compliance until December 31, 1984 — one and a half years after the contract was to expire and over three and a half years after

IMC ceased taking gas from Llano; it clearly did not relieve IMC of the obligation to pay.

The court of appeals did not believe that IMC should be excused by either force majeure or commercial impracticability (and indeed expressly found that the requisite notice for either was never given). Instead, the court devised two novel reasons for allowing IMC to escape its take or pay obligation under the contract: (1) as a matter of policy, corporations which cooperate with local regulatory agencies and comply prematurely with the letter and spirit of legally proper regulations are to be "encouraged"; and (2) "as a matter of law, government policy need not be explicitly mandatory to cause [commercial] impracticability" (App. A at 13), despite the fact that payment of the minimum bill was not at all impracticable.

The form of "encouragement" which the court chose, however, is a blatant exercise of judicial power to impair a contract. The court held in effect that a company will be encouraged to comply early with regulations by imposing the risks which the company had contracted to bear on the other party to the contract. This type of encouragement is antithetical to the (perhaps now outdated) tenant of contract law that parties are to be encouraged to perform their contracts.

Equally objectionable in this case is the court's argument that governmental policy need not be explicit or mandatory to cause commercial impracticability. The fact is that the pollution regulation was both explicit and mandatory — that companies must cut down particulates by December 31, 1984. The point is that IMC began curtailing its takes from Llano in June of 1980, three and a half years before final compliance with the regulation was necessary. Most important, the court fully ignored the fact that the EIB regulation did not affect IMC's ability to pay the minimum bill, while Llano stood ready to serve as required by the contract.

The cases cited by the court of appeals (App. A at 13-14) highlight the novel result reached here. In none of those cases was there an alternative obligation to pay a minimum bill if the defendant could not perform its primary obligation. The court

totally ignored that fundamental difference. In addition, all three of those cases involved the exigencies of war. In the first case, the government's "jawboning" was directed to immediate compliance; in the latter two cases the shipowners anticipated events (war or government requisitions for war) that may have occurred at any time. Immediate change in conduct in the context of war was involved in those cases; in IMC's case, on the other hand, the requisite compliance was years away. This is particularly significant because, as will be discussed below, IMC had ample time to notify Llano of these crucial circumstances. But no such notice was ever given, and Llano's attempt to deal with IMC's reduced takes received a cold shoulder.

2. The court's opinion was arbitrary and capricious and internally inconsistent on a dispositive issue. The result is inequitable to Llano and unconscionable.

The bitter irony of the court's opinion is highlighted by its comments on the requirements for, and absence of, notice by IMC to Llano. The contract required notice of any force majeure; otherwise, Llano would be forced to stand fully ready to serve without the option of seeking other opportunities to replace the purchases by IMC. IMC drafted, but never sent to Llano, a letter notifying Llano of IMC's reduced gas consumption and the reasons therefor. App. C at 14. The court found that IMC's notice to Llano "was inadequate in that no reasons were given as to why gas consumption would be decreased. Adequate notice was required to trigger the protections of the [force majeure] provision" (App. A at 10).

Another vital aspect of the notice issue was overlooked by the court of appeals. In September of 1980, Llano attempted to obtain IMC's approval to assign to a third party a portion of the gas supply that Llano had under purchase contract to supply IMC's maximum contract demand. The district court found that IMC did not indicate to Llano any lesser estimate of future gas consumption, nor did IMC respond in any fashion to Llano's request for assignment. Llano's good faith attempt to reach a solution acceptable to both parties was futile.

Incredibly, however, the court of appeals completely overlooks IMC's failure to give notice and failure to respond to Llano's request to assign the contract when the court discusses commercial impracticability, which is the doctrine the court relies on in excusing IMC. Not only does the court thus dispense with the requirements of notice in the contract, but it also fails to point out that a party invoking commercial impracticability has the duty to give reasonable notice (N.M. Stat. Ann. § 55-2-615(c) (1978) (Uniform Commercial Code)).[4] IMC certainly had the opportunity (and obligation) to give Llano notice — testing of the new equipment began in June of 1980, and the contract did not expire until two and a half years later.

IMC's conduct towards Llano can be described only as extreme bad faith: there was not a word to Llano of IMC's plans and intentions; this was a rebuff to Llano's request that part of the contract be assigned to alleviate the problem of IMC's reduced takes. IMC, particularly by this rebuff, compelled Llano to stand ready to render its full delivery obligation under the contract. IMC thus positioned itself to be able to call upon the "Llano option" if that option were needed. But when Llano asked IMC to fulfill its end of the bargain — by paying the minimum bill — IMC initiated litigation. Good faith demands honesty and candor, not deceit; yet the court below would reward that deceit because IMC complied early with environmental regulations in a manner which fulfilled its principal motive of reducing gas costs (App. C at 12).

The court's suggestion that Llano would have IMC polluting the air until the last moment is simply a mischaracterization of Llano's argument. Had IMC given notice of its plans or responded to Llano's request to assign the contract, the problem could have been resolved. Llano's argument, quite simply, is that IMC was perfectly capable of complying with its contract obligation to pay the minimum bill even if it chose to comply early with the environmental regulations. There should not be a public

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[4] Although Section 2-615 by its terms applies only to sellers, the court implicitly held that buyers may invoke its protection. Surely, however, a buyer must comply with the notice provisions of that section if that section is to be relied upon in the first instance.

policy which permits one to escape its payment obligations under such circumstances.

The court of appeals decision required it to support its opinion with findings directly contrary to the record and the district court's findings. The finding that Llano had been able to sell the gas elsewhere for a higher price (App. A at 7-8) is not established by the record. Indeed, the undisputed evidence showed that Llano stood ready each day to deliver that gas to IMC, not to someone else (Tr. 319-321).

The court also improperly found that failure to take gas reduced the minimum bill to zero. The court found that if IMC could not take gas, then the contract had the effect of lowering the buyer's minimum bill (App. A at 11). Accepting that conclusion *arguendo*, the proper next step would be to determine *how much* the bill was lowered. But the court inexplicably holds that IMC owed nothing because it "should not be required to pay for any natural gas it did not take under the contract" (App. A at 13).

The court of appeals stated that there was no technically suitable way for IMC to comply with the regulation other than the salting-out process (App. A at 13). To the contrary, the district court found that IMC failed to demonstrate that its inability to perform was caused by the regulation (App. C at 12). The district court did not decide the fact issue whether compliance with the regulation was possible only by utilizing the salting out process, and it was improper for the court of appeals to do so.

CONCLUSION

As noted above, the rationale of a minimum bill or take or pay clause is to shift to the buyer the risk that the gas will be marketable or consumed. These clauses have been in natural gas contracts for years. IMC and Llano voluntarily entered into the contract, and the contract contained a clause sanctioned by custom and usage for decades. The court of appeals' relentless disregard of the notice provisions of the contract and the requirements for notice under the doctrine of commercial impracticability, its refusal to allocate risks according to the contract agreed

upon by the parties and its notable failure to deal with Llano's attempt to deal with IMC's reduced takes led the court to an unprecedented result which put the court on the opposite side of the unanimous body of decisions on these clauses. In addition, it denotes the court's willingness to exceed the bounds of judicial propriety to achieve a desired result — a result desired by the court, not by the parties as expressed in their contract.

For the reasons stated, a writ of certiorari should issue to review the judgment and opinion of the Tenth Circuit.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing was served on all counsel of record in accordance with the rules on the 13th day of December, 1985, by first-class mail, postage prepaid.

JERON STEVENS
JERON STEVENS

APPENDIX A

PUBLISH

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 83-2657

INTERNATIONAL MINERALS AND CHEMICAL CORPORATION,
Plaintiff-Appellant,

versus

LLANO, INCORPORATED, *Defendant-Appellee.*

Appeal from the United States District Court
For the District of New Mexico
(Civil No. 82-165-M)

Keith A. Jones, John B. Ruhl of Fulbright & Jaworski, Washington, D.C., and James P. Houghton, Mark Thompson III of Modrall, Sperling, Roehl, Harris & Sisk of Albuquerque, New Mexico, Attorneys for Plaintiff-Appellant.

Don Maddox of Maddox & Renfrow, Hobbs, New Mexico, and Jeron Stevens of Baker & Botts of Houston, Texas, Attorneys for Defendant-Appellee.

Before BARRETT, DOYLE and MCKAY, Circuit Judges.

BARRETT, Circuit Judge

After examining the briefs and the appellate record, this three-judge panel has determined unanimously that oral argument would not be of material assistance in the determination of this appeal. *See* Fed. R. App. P. 34(a); Tenth Cir. R. 10(e). The cause is therefore submitted without oral argument.

International Minerals and Chemical Corporation (IMC) brought this diversity action against Llano, Inc. (Llano), seeking a declaratory judgment that it was excused from its obligation to pay for natural gas under a contract between IMC and Llano. Llano counterclaimed for $3,564,617.12, the amount it claimed was due under the contract. The district court granted judgment in favor of Llano and against IMC. The court found that IMC had no legal excuse for non-performance, and ordered IMC to pay Llano $3,441,869.79.

IMC, a New York corporation, operates a potash mine and processing facility near Carlsbad, New Mexico. At all times relevant to this action, IMC obtained the natural gas it needed to operate its facilities from Llano. Llano is a New Mexico corporation engaged in the business of intrastate transportation of natural gas by pipeline. The natural gas contract between Llano (seller) and IMC (buyer) that is the subject of this litigation was made in 1972, and continued in effect until June 30, 1982. It was amended only once, in 1975. That amendment concerned pricing structure as set forth in paragraph 5 of the contract, and is not an issue in this case. The pertinent portions of the contract are as follows:

> NOW, THEREFORE, in consideration of the premises and of the mutual convenants and agreements hereinafter set forth, the parties do hereby bargain, contract and agree as follows:
>
> 1. SUPPLY OF NATURAL GAS: Subject to the terms and conditions of this Contract, Seller will sell and deliver to Buyer and Buyer will take, purchase and pay for the entire fuel requirements of Buyer's Plant, provided that Buyer may at its option procure and maintain a supply of standby fuel to be used only to such extent as may be necessary when the gas supply from Seller may be interrupted or curtailed, as

hereinafter provided, and in such other amounts as may be necessary from time to time to test such standby facilities and fuel.

* * *

6. DELIVERY REQUIREMENTS: During the term of this Contract, unless Seller agrees in writing to the contrary, the minimum daily deliveries that Seller shall make to Buyer and Buyer shall take from Seller shall be 4800 million BTU's per day except as hereafter provided. The maximum daily deliveries that Seller shall be required to make to Buyer shall be 133% of the average daily requirements of Buyer's Plant for the preceding 365 days provided, however, Seller shall at no time be required to deliver in excess of 6400 million BTU's per day unless Seller agrees in writing to the contrary.

Buyer does not contemplate reducing its operations, but on the contrary contemplates the increase thereof from the present daily requirements. In order to meet unanticipated contingencies, it is agreed that in the event Buyer during the term of this Contract reduces its operation by closing a portion of its plant, it shall have the right upon six months notice in writing to reduce the minimum requirements to a figure equal to 70% of the stated minimum of 4800 million BTU's per day. In the event of such reduction in minimum requirements, Seller's price to Buyer then in effect under the terms hereof shall be increased by ½¢ per million BTU's, but not in excess of the highest price for a like quantity of gas then being paid by any potash company in the area.

7. MINIMUM ANNUAL PURCHASE: During the term of this Contract, commencing with the first year, Buyer agrees to take from Seller a volume of gas having a BTU content of not less than 355 times the minimum daily deliveries specified in Section 6 hereof. Buyer agrees to pay Seller for such minimum volume of gas at the price set forth in Section 5 hereof provided that if Buyer fails during any calendar year to take such minimum volume of gas, then the deficiency between the volume actually taken and Buyer's minimum purchase obligation shall be paid at the price in effect during the calendar year in which such deficiency occurs.

Billing for any payment due by reason of a deficiency in Buyer's takings of gas hereunder during a particular calendar year shall be included on the bill rendered to Buyer for gas delivered to Buyer during the month of December in the calendar year in which such deficiency occurred and payment therefor shall be made in the manner provided for monthly bills in Section 11 hereof. Failure on the part of Seller to so bill Buyer for any such deficiency payment shall not constitute a waiver hereof by Seller.

* * *

15. FORCE MAJEURE: Either party shall be excused for delay or failure to perform its agreements and undertakings, in whole or in part, when and to the extent that such failure or delay is occasioned by fire, flood, wind, lightning, or other acts of the elements, explosion, act of God, act of the public enemy, or interference of civil and/or military authorities, mobs, labor difficulties, vandalism, sabotage, malicious mischief, usurpation of power, depletion of wells, freezing or accidents to wells, pipelines, permanent closing of Buyer's operations at its Eddy County mine and refinery, after not less than six (6) months notice thereof to Seller, or other casualty or cause beyond the reasonable control of the parties, respectively, which delays or prevents such performance in whole or in part, as the case may be; provided, however, that the party whose performance hereunder is so affected shall immediately notify the other party of all pertinent facts and take all reasonable steps promptly and diligently to prevent such causes if feasible to do so, or to minimize or eliminate the effect without delay. It is understood and agreed that settlement of strikes or other labor disputes shall be at the sole discretion of the party encountering the strike or dispute.

Nothing contained herein, however, shall be construed as preventing the Buyer from discontinuing the operation of the plant for such periods of time as may be required by Buyer to perform necessary overhaul operations on plant properties or to accomplish preventative maintenance operations on such plant properties, which the Buyer may determine as necessary to safeguard its investment in the plant.

> 16. ADJUSTMENT OF MINIMUM BILL: In the event that Seller is unable to deliver or Buyer is unable to receive gas as provided in this Contract for any reason beyond the reasonable control of the parties, or in the event of force majeure as provided in Section 15 hereof, an appropriate adjustment in the minimum purchase requirements specified in Section 7 shall be made.

(Pl. Exh.3, Def. Exh. C8b).

The contract may be characterized as a requirements contract, with an important limitation: Pursuant to paragraph 6, the buyer (IMC) is obligated to take, at a minimum, a daily average of 4800 million BTU's of gas. Pursuant to paragraph 7, if the buyer does not take this minimum amount, the buyer is obligated to pay for the minimum amount of gas anyway. These provisions are known in the industry as "take or pay" provisions, the purpose of which is to compensate the seller for being ready at all times to deliver the maximum amount of gas to the buyer and to eliminate the risk that the seller would face in a pure requirements contract were the buyer's requirements to drop too low. *See, e.g., Utah International, Inc. v. Colorado — Ute Electric Association*, 425 F. Supp. 1093 (D. Colo. 1976) ("take or pay" coal purchase contract); *Mobil Oil Corporation v. Tennessee Valley Authority*, 387 F. Supp. 498 (N.D. Ala. 1974) ("take or pay" electricity contract). The harshness of the "take or pay" provisions in this contract are to some extent ameliorated by the "force majeure" provision of paragraph 15 and the "adjustment of minimum bill" provision of paragraph 16; paragraphs 15 and 16 are discussed below.

At the time the contract was made, IMC operated nine submerged combustion evaporators (Ozarks) at its plant. These Ozarks were gas-fired boilers in which a mixture of water and the ores sylvinite (potassium chloride) and langbeinite (potassium magnesium sulphate) was heated. The excess water was boiled off, and the hot solution was subsequently cooled. When the solution was cooled, potassium sulfate would crystallize out of solution. This potassium sulphate was marketed commercially as a fertilizer. These Ozarks were fitted with stacks that emitted large amounts of fine particulates, resulting in air pollution.

Initially, the particulate emissions from these Ozarks were not regulated by the New Mexico Environmental Improvement Board (EIB). In December, 1978, however, the EIB promulgated Regulation 508. (Pl. Exh. 19, Def. Exh. A-23). Paragraph C of that regulation limited emissions from potash processing equipment (i.e., Ozarks) to 30 pounds per hour. Compliance was to be achieved "as expeditiously as practicable" and not later than December 31, 1982. Paragraphs D and E allowed operators the option of replacing submerged combustion evaporators (i.e., Ozarks) with alternative technology, in which case emissions were required to be reduced to 350 pounds per hour by December 31, 1982 and to 30 pounds per hour by December 31, 1984. IMC participated with the EIB in the Rule 508 rulemaking process, and was especially instrumental in getting the alternative provisions of paragraphs D and E included.

Before the promulgation of Rule 508, IMC had considered different ways to reduce the particulate emissions of the Ozarks. IMC looked at the "Venturi Scrubber," the "Brink Mist Eliminator," and the "Multiple Effect Evaporator" systems. The first two systems were designed to remove particulates from the exiting gas stream, and the latter system was designed to heat the solution in such a way that no particulates were created. Because of various technical problems with each of these alternatives[1], IMC had concluded by the end of 1978 that its best hope for achieving compliance with Rule 508 was in a solar evaporation process. Accordingly, a timely statement of intent to adopt the solar evaporation process and petition for compliance schedule were

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[1] IMC's general manager at the Carlsbad plant testified that the "Venturi Scrubber" had never been used in this particular way, and that because of the very fine size of the particulates there were doubts that the scrubbers could reduce emissions sufficiently to come into compliance with Rule 508. The "Brink Mist Eliminator" utilized a filter that would plug up almost immediately. The filter had to be washed with dilute sulfuric acid, which had to be neutralized with limestone. That process in turn caused a sludge problem. The "Multiple Effect Evaporator" had been used in another mine. Their experience had been that the titanium tubing used in the system would clog with langbeinite deposits in a matter of days or weeks, forcing a shutdown while the tubing was drilled clean. There were also serious corrosion and abrasion problems. R. Vol. IV at 503-512.

filed with the EIB on March 30, 1979. (Pl. Exh. 21). The EIB adopted a schedule of compliance for IMC on July 13, 1979. (Pl. Exh. 22). IMC experimented with the solar evaporation process for about a year, and eventually concluded that this process, too, was technically infeasible. In May, 1980, IMC sought from EIB an amended compliance schedule to give IMC a chance to experiment with a "salting out process" (SOP), whereby the potassium sulphate would be extracted from solution by chemical precipitation. (Pl. Exh. 23). An amended compliance schedule for IMC was adopted by EIB on July 11, 1980. (Pl. Exh. 25).

Meanwhile, an IMC employee notified Llano by telephone on May 21, 1980 that IMC would begin testing on June 2 and that gas consumption would be 50%-60% of the normal usage during that time. This was followed by a second telephone call in August, informing Llano that testing would continue. In neither of these calls was Llano informed that the testing was in response to environmental problems, or that the reduced gas consumption might be permanent because of a "force majeure" situation.

IMC's tests of the SOP were successful, and on March 20, 1981, IMC advised the EIB that the SOP was commercially operational and that "IMC will be able to immediately eliminate continued use of the evaporators in the potassium sulphate manufacturing process." (Pl. Exh. 29).

The Ozarks, when they had been in operation, had consumed approximately 60% of IMC's natural gas requirements. The result of IMC's change to the SOP in response to Rule 508 was that the Ozarks were shut down and IMC did not take its minimum obligation of natural gas during the last eighteen months that the contract was in effect (January, 1981 — June, 1982).

In its action for declaratory judgment, IMC claimed that it was excused from its obligation to "take or pay" under a variety of legal and equitable defenses. The trial court rejected each defense, and found that IMC was liable to pay Llano for the full value of the gas not taken (i.e., the amount of the minimum purchase obligation, less the gas actually purchased, multiplied by the purchase price per unit of gas), even though Llano had, in

fact, been able to sell the gas elsewhere for a higher price than it would have receiv IMC. Our focus will be on the trial court's findings w pect to the common law doctrine of impossibility/impracticability and the "force majeure" and "adjustment of minimum bill" clauses in the contract.

The trial court found that the common-law doctrine of impossibility/impracticability, as codified in Section 2-615 of the Uniform Commercial Code (N.M. Stat. Ann. § 55-2-615 (1978)), was not applicable in this case. The court found that Section 2-615, by its terms, applies only to sellers, and read Official Comment 9 to say that the section can apply to buyers only "where the buyer's contract is in reasonable commercial understanding conditioned on a definite and specific venture or assumption . . .." The court found that such was not the case here.

With respect to the "force majeure" and "adjustment of minimum bill" paragraphs 15 and 16, the court found that these provisions did not excuse IMC from its contract obligations. These provisions would have been applicable only if the EIB regulation had prohibited absolutely IMC's daily purchase of 4800 million BTU's of gas. The court thus construed the provisions of paragraphs 15 and 16 to excuse performance only if it became absolutely impossible or illegal to purchase the minimum amount of gas. Though the court recognized that IMC had found compliance through the fitting of "scrubbers" on the Ozarks' stacks to be technically unsuitable, such a finding did not, in the court's view, help IMC. This was because IMC had voluntarily cooperated with the EIB, and had come into compliance earlier than required. IMC had therefore not done all it could to surmount the obstacles to performance, and thus could not claim that it was unable to comply for reasons beyond its control.

In this appeal, IMC contends that: (1) IMC's supervening need to comply with environmental regulations excused its duty of performance under both (a) the common law doctrine of impossibility/impracticability as codified under Section 2-615 of New Mexico's Uniform Commercial Code, and (b) the "force majeure" and "adjustment of minimum bill" provisions of the contract; (2) the "minimum payment" clause of the contract

constitutes an unenforceable penalty; (3) the contract as a whole is unconscionable; and (4) the trial court incorrectly calculated the amount of damages owing in the event the contract is found to be enforceable. We consider only the two parts of IMC's first contention.

On a fundamental level, this case is one of contract construction. Our primary objective, as always, in the construction or interpretation of a contract is to ascertain the intention of the parties. *Schultz & Lindsay Construction Co. v. State*, 494 P.2d 612, 613 (N.M.1972); *Yankee Atomic Electric Company v. New Mexico and Arizona Land Company*, 632 F.2d 855, 858 (10th Cir. 1980) (interpreting New Mexico law.) We assume that the parties intended a reasonable interpretation of the language. *Smith v. Tinley*, 674 P.2d 1123, 1125 (N.M.1984). Accordingly, the legal context in which the contract was made will be relevant. As mentioned above, paragraphs 15 and 16 ameliorate the harshness of the "take or pay" provisions in that either party's duty of performance may be excused upon the occurrence of certain contingencies. As we examine the language of paragraphs 15 and 16, an appropriate area to look for guidance is the common law doctrine of impossibility/impracticability, codified at Section 2-615 of New Mexico's Uniform Commercial Code (N.M. Stat. Ann. § 55-2-615 (1978)), which was the law in New Mexico at the time the parties contracted and which remains the law today. While it is a basic premise of both Section 2-615 and the Uniform Commercial Code in general that the parties may allocate risks and penalties between themselves in any manner they choose, N.M. Stat. Ann. §§ 55-1-102 and 55-2-615 (1978), the Code and the common law upon which it is based remain a significant backdrop.[2]

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[2] Section 2-615 of the Uniform Commercial Code (N.M. Stat. Ann. § 55-2-615 (1978) provides in pertinent part:

55-2-615 Excuse by failure of presupposed conditions.

Except so far as a seller may have assumed a greater obligation and subject to the preceding section . . . on substituted performance:

(a) delay in delivery or nondelivery in whole or in part by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency, the nonoccurrence of which was a basic assumption on

We first consider the effect of paragraph 15, the "force majeure" provision, on IMC's duty of performance under the circumstances of this case. Specifically, paragraph 15 provides that either party is excused from performance if failure or delay in performance is "occasioned" by such events as fire, flood, act of God, interference of civil and/or military authorities, etc. The party seeking to be excused from performance must provide the other party with immediate notice of all pertinent facts and take all reasonable steps to prevent the occurrence. It also appears that the seller is entitled to six months notice before the buyer can be excused. We agree with the trial court that paragraph 15 does not operate to excuse IMC, although our conclusion is based on a somewhat different rationale. First, IMC's notice to Llano was inadequate in that no reasons were given as to why gas consumption would be decreased. Adequate notice was required to trigger the protections of the provision. Second, even if we assume *arguendo* that Rule 508 prevented IMC from taking the gas, Rule 508 would still pose no obstacle to IMC's ability to pay. Since this is a "take or pay" contract, the buyer can perform in either of two ways. It can either (1) take the minimum purchase obligation of natural gas (and pay) or (2) pay the minimum bill. It is settled law that when a promisor can perform a contract in either of two alternative ways, the impracticability of one alternative does not excuse the promisor if performance by means of the other alternative is still practicable. *Ashland Oil and Refining Co. v. Cities Service Gas Co.*, 462 F.2d 204, 211 (10th Cir. 1972); *Glidden Company v. Hellenic Lines, Limited*, 275 F.2d 253, 257 (2d Cir. 1960); Restatement (Second) of Contracts § 261, comment f (1981). Paragraph 15 does not compel a different result;

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which the contract was made, or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid;

Official Comment 8 (which we regard as persuasive authority, even though it is not a part of the statute) provides *inter alia*: Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions at this section are to be read in the light of mercantile sense and reason, for this section sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go.

it would at most excuse IMC from its duty to "take," not from its duty to "pay."

Paragraph 16, the "minimum bill" provision, however, affords the buyer additional protection. It provides that, in the event the buyer is "*unable* to receive gas as provided in the Contract for any reason *beyond the reasonable control* of the parties . . . " (emphasis added), then "an appropriate adjustment in the minimum purchase requirements specified in Section [paragraph] 7 shall be made." Paragraph 7, in turn, provides for a minimum bill based on the difference between the buyer's minimum purchase obligation and the gas actually taken. It follows that an adjustment of the buyer's minimum purchase requirements made pursuant to paragraph 16 would have the effect of lowering the buyer's minimum bill under paragraph 7. Llano's contention that paragraph 16 provides for a reduction in IMC's minimum purchase obligation but not its minimum bill obligation (Appellee's Brief at 4) is thus quickly disposed of.

The determinative question, then, is: Did the promulgation of Rule 508 constitute an event beyond the reasonable control of IMC that rendered IMC "unable" to receive its minimum amount of gas under the contract?

A simplistic, literal interpretation of the word "unable" would, in our view, be inappropriate and lead to absurd results: IMC could never be "unable" to take Llano's gas; IMC could always take the gas and vent it into the air, even if its facilities were completely destroyed. The word "unable" appears here as a term in a contract, prepared by businessmen and attorneys; thus, it is appropriate to construe the term in light of the common law as it existed in New Mexico when the contract was entered into. For our purposes, then, "unable" is synonymous with "impracticable," as that term is used in the common law and in Section 2-615.

The term "impracticable" has, over the years, acquired a fairly specific meaning. Although earlier cases required that performance be physically impossible before the promisor would be excused, strict impossibility is no longer required. *See* Restatement of Contracts (Second) § 261, comment d (1981). The

New Mexico Supreme Court has described the doctrine of impracticability as follows:

> Regarding the meaning of "impossibility" as used in the rules that excuse the non-performance of contracts, it is stated:
>
> > "As pointed out in the Restatement of Contracts, the essence of the modern defense of impossibility is that the promised performance was at the making of the contract, or thereafter became, impracticable owing to some extreme or unreasonable difficulty, expense, injury, or loss involved, rather than that it is scientifically impossible. * * * The important question is whether an unanticipated circumstance has made performance of the promise vitally different from what should reasonably have been within the contemplation of both parties when they entered into the contract. If so, the risk should not fairly be thrown upon the promisor." *Wood v. Bartolino*, 146 P.2d 883, 886 (N.M. 1944), *quoting* 6 Williston on Contracts, § 1931.

Cf. Gulf Oil Corporation v. Federal Power Commission, 563 F. 2d 588, 599 (3d. Cir. 1977), *cert. denied* 434 U.S. 1062 (1978) ("The crucial question in applying that doctrine to any given situation is whether the cost of performance has in fact become so excessive and unreasonable that the failure to excuse performance would result in grave injustice. . . ."); *Mineral Park Land Co. v. Howard*, 156 P. 458,460 (Cal.1916) ("a thing is impracticable when it can only be done at an excessive and unreasonable cost").

Performance will be excused when made impracticable by having to comply with a supervening governmental regulation. N.M. Stat. Ann. § 55-2-615 (1978); Restatement of Contracts (Second) § 264 (1981). Thus, for example, in the case of *Kansas City, Missouri v. Kansas City, Kansas*, 393 F. Supp.1 (W.D. Mo. 1975), the court held that the defendant city's obligation to accept the plaintiff city's sewage was excused by the enactment of the Federal Water Pollution Control Act Amendments of 1972. The federal act imposed new requirements with regard to the treatment of sewage that was discharged into the Missouri River; the court found that the added expense of such treatment would

impose a significant, unreasonable burden on the defendant. *Accord City of Vernon v. City of Los Angeles*, 290 P. 2d 841 (Cal.1955).

Inasmuch as there was no technically suitable way for IMC to comply with the EIB's Regulation 508 without shutting down the Ozarks and changing to the SOP, with the concomitant decrease in natural gas consumption, we hold that the adjustment provision of paragraph 16 of the contract was triggered. IMC was unable, for reasons beyond its reasonable control, to receive its minimum purchase obligation of natural gas between January 1, 1981 and June 30, 1982; thus, the minimum bill should have been adjusted appropriately. IMC should not be required to pay for any natural gas it did not take under the contract.

Llano contends that there was no supervening legal impracticability in this case because IMC was not required to be in final compliance until December 31, 1984, and that IMC cooperated with the EIB and came into compliance too early. The argument here is that, notwithstanding the interim standards contained in the schedules of compliance, IMC should have stalled in its negotiations with the state regulatory agency, which would have resulted in the pollution of air until the last minute. We must reject this contention on two grounds: First, as a matter of policy, individuals and corporations who cooperate with local regulatory agencies and comply with the letter and spirit of legally proper regulations, environmental or otherwise, are to be encouraged. Stalling tactics are not regarded favorably. Second, as a matter of law, government policy need not be explicitly mandatory to cause impracticability. Thus, for example, in *Eastern Air Lines, Inc. v. McDonnell Douglas Corporation*, 532 F.2d 957 (5th Cir. 1976), an aircraft manufacturer was excused from its contractual obligation to deliver commercial jet airliners on certain scheduled dates because it had voluntarily complied with government requests to expedite production of military equipment needed for the war in Vietnam. Similarly, in the maritime context, shipowners have been excused from contractual obligations because they have anticipated governmental intrusion. *The Kronprinzessin Cecilie*, 244 U.S. 12 (1917) (German ship was justified in returning to New York rather than completing a voyage to Great Britain and

France on the eve of the outbreak of hostilities in World War I); *The Clavaresk*, 264 F. 276 (2d Cir. 1920) (shipowner may anticipate and need not resist government requisition of his ship for wartime service in order to be excused from performance of a charter agreement). There is, we recognize, a limit to the extent to which an individual can seek refuge in the context of a case such as this by cooperating with the government: "any action by the party claiming excuse which causes or colludes in inducing the governmental action preventing his performance would be in breach of good faith and would destroy his exemption." Official Comment 10, N.M. Stat. Ann. § 55-2-615 (1978). Here, Regulation 508 was promulgated by the EIB as part of New Mexico's State Implementation Plan mandated by the Clean Air Act. Regulation 508's existence and its enforcement mechanism is designed to eliminate pollution of the environment, thus serving the public health and welfare. IMC's recognition of the public benefit goal and its willingness to cooperate in eliminating pollution can hardly be termed improper collusion.

For the reasons described above, the judgment of the trial court in favor of Llano is REVERSED. The case is REMANDED with direction that the court enter a declaratory judgment in accordance with this opinion.

APPENDIX B

JULY TERM
(September 18, 1985)

Before Honorable JAMES E. BARRETT, Honorable WILLIAM E. DOYLE, and Honorable MONROE G. MCKAY, Circuit Judges

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No. 83-2657

INTERNATIONAL MINERALS AND CHEMICAL CORPORATION,
Plaintiff-Appellant,

versus

LLANO, INC., *Defendant-Appellee.*

This matter comes on for consideration of appellee's petition for rehearing filed in the capitioned cause.

Upon consideration whereof, the petition for rehearing is denied.

.....
HOWARD K. PHILLIPS, Clerk

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW MEXICO

No. 82-165-M Civil

INTERNATIONAL MINERALS AND CHEMICAL CORPORATION,
Plaintiff,

versus

LLANO, INC. *Defendant.*

Memorandum Opinion and Order

This matter came on for bench trial on July 18, 1983. This opinion constitutes my findings of fact and conclusions of law pursuant to Fed.R.Civ.P. 52(a).

This diversity case arises from a contract for delivery of natural gas executed by the parties on February 24, 1972. The plaintiff, International Minerals and Chemical Corporation (IMC), is a New York corporation operating a potash mining facility near Carlsbad, New Mexico. IMC's principal offices are in Northbrook, Illinois. The defendant, Llano, Inc. (Llano), is a New Mexico corporation in the business of intrastate transportation of natural gas. Plaintiff seeks a declaratory judgment determining its rights and duties under the contract. Defendant has counterclaimed for damages alleging that IMC has breached the contract by failing to make payments for gas contracted for but not taken for the year ending December 31, 1981, and for the period from January 1, 1982 through June 30, 1982. Llano also sought damages for construction and storage costs, but has withdrawn this claim.

IMC and Llano entered into a contract in 1961 which provided that Llano was to supply natural gas to IMC for use at its Carlsbad facility for a period of ten years. That contract expired and was replaced in 1972 with the contract at issue here. The bulk of the gas supplied under the two contracts was burned in IMC's Ozark submerged evaporators (Ozarks) as part of a drying process used in the manufacture of chemical fertilizers. The Ozarks released particulates through smoke stacks, causing air pollution. As early as 1971, IMC began studying alternatives to the Ozark drying process, as both a possible means of eliminating the pollution and reducing the fuel cost the Ozarks required.

On May 28, 1975, the parties, by letter agreement, amended the contract. This was the only amendment affecting the contract, and related only to the pricing structure as set forth in ¶ 5 of the contract.

On December 15, 1978, the Environmental Improvement Board (EIB) of the State of New Mexico adopted its Air Quality Control Regulation 508 concerning particulate emissions of potash, salt or sodium sulfate processing equipment. The regulation set forth alternative schedules of compliance with allowable emission rates. It called for reduction of particulate emissions in excess of 30 pounds per hour "[a]s expeditiously as practicable, but not later than December 31, 1982." Paragraph D of the regulation provided an alternative method of compliance for persons owning processing equipment "which includes submerged combustion equipment which have no controls for particulate matter." Such persons could file, within 30 days of the effective date of the regulation, "a written statement of intent to replace the submerged combustion evaporators with solar or other evaporators with total particulate matter emissions inherently less than 30 pounds per hour." Paragraph E provided the alternative schedule of compliance for persons submitting a timely statement of intent. It called for the reduction of emissions caused by such persons in excess of 350 pounds per hour after December 31, 1982, and in excess of 30 pounds per hour after December 31, 1984.

IMC had studies for reducing particulate emissions or drying methods not requiring Ozarks that began before the EIB adopted

its Regulation 508. IMC attended a series of meetings with the EIB concerning promulgation of Regulation 508, and its recommendations were instrumental and included as provisions in the final draft.

On March 30, 1979, pursuant to ¶ D, IMC filed a timely statement of intent to replace the Ozarks with solar evaporators, conditioned upon the successful operation of a prototype system. Included with the statement was a "Petition for Compliance Schedule" showing intended modifications of IMC's Carlsbad operations pursuant to Regulation 508. The EIB adopted IMC's schedule of compliance on July 13, 1979. IMC experimented for about a year with the solar evaporation process, which proved unsatisfactory. In May, 1980, IMC notified the EIB of its election to replace the solar evaporators with a "salting out" process. On July 11, 1980, the EIB approved IMC's amended schedule of compliance showing that the Ozarks would be replaced with a "salting out" process, which, if successful, would result in elimination of the Ozarks well in advance of December 31, 1984.

On May 21, 1980, IMC notified Llano, by telephone, that it would begin "testing" on June 2, 1980 for three to four weeks, and that IMC's gas consumption would be reduced by about 50% for that period. Testing of the "salting out" process began about June 2, 1980, at which time the Ozarks were shut off. Since then, the Ozarks have been dismantled. The "salting out" process utilizes virtually no natural gas, and IMC's consumption of natural gas was reduced by about 60% when the "salting out" testing began.

The dispute arises from the contract's minimum/maximum daily delivery requirements set forth in ¶ 6, and IMC's minimum annual purchase obligation, as provided in ¶ 7. These clauses read as follows:

> 6. DELIVERY REQUIREMENTS: During the term of this Contract, unless Seller agrees in writing to the contrary, the minimum *daily deliveries that Seller shall make to Buyer* and *Buyer shall take from Seller* shall be *4800 million BTU's* per day except as hereafter provided. The maximum daily deliveries that Seller shall be required to make to Buyer shall

be 133% of the average daily requirements of Buyer's Plant for the preceding 365 days provided, however, *Seller shall at no time be required to deliver in excess of 6400 million BTU's per day* unless Seller agrees in writing to the contrary.

Buyer does not contemplate reducing its operations, but on the contrary contemplates the increase thereof from the present daily requirements. In order to meet unanticipated contingencies, it is agreed that in the event Buyer during the term of this Contract reduces its operation by closing a portion of its plant, it shall have the right upon six months notice in writing to reduce the minimum requirements to a figure equal to 70% of the stated minimum of 4800 million BTU's per day. In the event of such reduction in minimum requirements, Seller's price to Buyer then in effect under the terms hereof shall be increased by ½¢ per million BTU's, but not in excess of the highest price for a like quantity of gas then being paid by any potash company in the area.

7. MINIMUM ANNUAL PURCHASE: During the term of this contract, commencing with the first year, Buyer agrees to take from Seller a volume of gas having a BTU content of not less than 355 times the minimum daily deliveries specified in Section 6 hereof. Buyer agrees to pay Seller for such minimum volume of gas at the price set forth in Section 5 hereof; provided that if Buyer fails during any calendar year to take such minimum volume of gas, then the deficiency between the volume actually taken and Buyer's minimum purchase obligation shall be paid at the price in effect during the calendar year in which such deficiency occurs.

Billing for any payment due by reason of a deficiency in Buyer's takings of gas hereunder during a particular calendar year shall be included on the bill rendered to Buyer for gas delivered to Buyer during the month of December in the calendar year in which such deficiency occurred and payment therefore shall be made in the manner provided for monthly bills in Section 11 hereof. Failure on the part of Seller to so bill Buyer for any such deficiency payment shall not constitute a waiver hereof by Seller. (Emphasis in original.)

It is clear in this case, as it was in *Utah Int'l, Inc. v. Colorado-Ute Electrical Ass'n, Inc.*, 425 F.Supp. 1093 (D.Colo. 1976), that one of the effects of the minimum purchase obligation is that Llano could at all times require that IMC take or pay for the contractual minimum amount of gas, regardless of its actual fuel requirements. As Judge Arraj recognized, "[s]uch a purchase obligation is a protective provision for the seller and as such eliminates some of the risk for seller which normally attend the type of requirements contract containing no such minimum purchase obligation." *Id.*, at 1097. IMC does not deny the general enforceability of minimum purchase clauses, nor would such an attack have merit. *See Mobil Oil Corp. v. Tennessee Valley Authority*, 387 F.Supp. 498 (N.D.Ala. 1974). Rather, IMC sets up a variety of legal and equitable defenses, and asserts that it is excused from performance under one or another defense. IMC also argues that the contract is subject to the Uniform Commercial Code, N.M.Stat.Ann. §§ 55-1-101 *et seq.*, and that either its performance is excused, or Llano's remedies are limited, by various provisions of the U.C.C. In addition, IMC contends that the circumstances described above and leading to its reduction in natural gas consumption constitute force majeure, and it is thus excused under the provisions of ¶ 15 of the contract.

I.
UNIFORM COMMERCIAL CODE

IMC relies on *Amoco Pipeline Co. v. Admiral Crude Oil Corp.*, 490 F.2d 114 (10th Cir. 1974) for its contention that this contract is governed by the U.C.C. In that case, the applicability of the U.C.C. to the sale of crude oil was decided by the district court, and I don't find the issue was raised on appeal. Even if it is assumed that the sale of natural gas here is a sale of goods and governed by the U.C.C., §2-107, this assumption does not provide the relief asserted by IMC.

First, IMC argues that the contract is a requirements contract, and that its good faith cessation of natural gas requirements terminates its liability for payment for gas in excess of its requirements. It cites *Utah Int'l v. Colorado-Ute Elec Ass'n, Inc., supra,* in support of this contention. That case noted that

such a contract "is not, however, a prime requirements contract, but one modified by the maximum seller's obligation and the minimum buyer's obligation." 425 F.Supp. at 1096. IMC's assertion that its obligation to purchase natural gas only in such quantities is measured by its "actual requirements as occur in good faith" is based on the language of U.C.C. § 2-306. This section of the Code, IMC argues, relieves it of any obligation to pay for gas not required by it as a result of its good faith conversion to the "salting out" process pursuant to EIB regulations. Admittedly, U.C.C. § 2-306 provides for reasonable elasticity and good faith variation in requirements. However, Official Comment 3 to § 2-306 provides: "Any minimum or maximum set by the agreement shows a clear limit on the intended elasticity." IMC's argument that its minimum purchase obligation was, at best, an "estimate" of its requirements is without merit.

IMC next relies on U.C.C. § 2-615 to excuse its obligations under the contract. This section "excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting." While § 2-615 seems to apply only to sellers, IMC cites *Nora Springs Cooperative Co. v. Brandau*, 247 N.W.2d 744 (Iowa 1976) as authority for its applicability to buyers as well. The *Brandau* case relies on Comment 9 as evidence of the section's equal applicability to buyers. However, Comment 9 is not nearly so broad, and applies the reasoning of § 2-615 entitling the *buyer* to its exemption only in cases "where the buyer's contract is in reasonable commercial understanding conditioned on a definite and specific venture or assumption . . .." I find that the contract here was not so conditioned, and refuse to follow the general language of *Brandau* on this issue. U.C.C. § 2-615 thus affords no remedy to IMC.

IMC also raises as a defense the doctrine of unconscionability as set out in U.C.C. § 2-302. This defense is available "[i]f the court, as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made." I do not find any provision of the contract to have been unconscionable at the time of execution. *See infra*, at 11.

Finally, under the U.C.C., IMC argues that what it labels Llano's "minimum obligation claim", as being barred by U.C.C. § 2-709. The claim was submitted to IMC by Llano in a minimum billing statement pursuant to ¶¶ 6 and 7 of the contract and is asserted by Llano as its claim for damages for IMC's alleged breach. IMC characterizes this claim as an action for price, and argues that U.C.C. § 2-709 is the exclusive remedy section when the seller seeks to recover price. Llano denies that it is suing for "price", and argues that its claim is for the amount IMC contracted to pay for the *availability* of natural gas.

IMC's position is that the only possibly valid portion of Llano's "minimum obligation claim" is the one for natural gas identified to the contract and held in storage by Llano for IMC. IMC further asserts that, upon its payment of the price, it is entitled to take possession of the gas. However, in its argument on this point, IMC ignores the U.C.C.'s underlying policy of freedom of contract as expressed in § 1-102(3). Furthermore, the Code, in § 2-719, specifically leaves the parties free to shape their remedies according to their particular needs. U.C.C. § 2-719, Comment 1; *Frank Leroux, Inc. v. Burns*, 4 Wash.App. 165, ... , 480 P.2d 213, 215 (Ct.App. 1971), *noted in* Annot., 90 A.L.R.3d at 1146 (1979). *See also Jamestown Farmers Elevator, Inc. v. General Mills*, 413 F.Supp. 764, 772 (D.N.D. 1976) (§ 2-719 "specifically allows for additional remedies"); *Equitable Lumber Corp. v. IPA Land Development Corp.*, 38 N.Y. 2d 516, ... , 344 N.E.2d 391, 394, 381 N.Y.S.2d 459, (1976) ("variations on the code's damages scheme are permitted by subdivision (1) of Section 2-719").

In *Frank Leroux, Inc. v. Burns, supra*, the court rejected the argument that the seller's exclusive remedies were those provided in the Code in §§ 2-709 and 2-703. The court said: "In other words, it is defendants' [buyers'] contention that plaintiff's [seller's] remedy is limited to those provided in the statutes above quoted [§§ 2-709 and 2-703] and cannot be contracted away by agreement of the parties. We are unable to agree." 480 P.2d at 215. In that case, as here, there was no evidence that the U.C.C. obligations of good faith, diligence, reasonableness and care were in any way disclaimed by the agreement of the parties. Neither was there "evidence that the agreement or any part of it

was unconscionable so as to render it unenforceable [§ 2-302], nor that the remedy agreed upon is unreasonable in a commercial context." *Id.* Section 2-719's provisions "for remedies in addition to or in substitution for those provided in [Article 2]" are subject further to limitations for liquidation of damages contained in § 2-718. However, IMC does not argue that the "take or pay" clause is void as a penalty. Such a challenge was overruled in *Mobil Oil Corp. v. TVA*, *supra*. Thus, the minimum annual purchase obligation provided for in ¶ 7 of the contract is enforceable under Article 2 of the Code.

II.
OTHER DEFENSES

IMC also relies on a variety of common law and equitable defenses as excusing its performance. Before discussing these other defenses, I note that, in several memoranda, IMC repeats verbatim its contention that any construction of the "minimum annual purchase" obligation which would allow Llano to recover the price for gas not taken by IMC is unconscionable as a matter of law. Yet, this construction of IMC's obligation is precisely what the parties agreed upon: "Buyer agrees to pay Seller for such minimum volume of gas at the price set forth in Section 5 hereof." ¶ 7, Natural Gas Contract. The minimum volume is calculated at 355 times the minimum daily delivery (4800 million BTU's) for each calendar year. In return for this promise, Llano was required to have available for delivery to IMC up to 6400 million BTU's per day, whether IMC purchased that amount or not. The evidence shows that such a minimum purchase obligation is a common feature in gas supply contracts. In this context, I cannot find such a provision unconscionable as a matter of law, *supra* at 9. *See, Utah Int'l, Inc. v. Colorado-Ute, supra*, at 1096-97.

FORCE MAJEURE

Some of the legal and contract defenses raised by IMC can be gathered under the heading "force majeure". ¶¶ 15 and 16 of the contract provide:

15. FORCE MAJEURE. Either party shall be excused for delay or failure to perform its agreements and undertakings, in whole or in part, when and to the extent that such failure or delay is occasioned by fire, flood, wind, lightning, or other acts of the elements, explosion, act of God, act of the public enemy, or interference of civil and/or military authorities, mobs, labor difficulties, vandalism, sabotage, malicious mischief, usurpation of power, depletion of wells, freezing or accidents to wells, pipelines, permanent closing of Buyer's operations at its Eddy County Mine and refinery, after not less than six (6) months notice thereof to Seller, or other casualty or cause beyond the reasonable control of the parties, respectively, which delays or prevents such performance in whole or in part, as the case may be; provided, however, that the party whose performance hereunder is so effected shall immediately notify the other party of all pertinent facts and take all reasonable steps promptly and diligently to prevent such causes if feasible to do so, or to minimize or eliminate the effect without delay. It is understood and agreed that settlement of strikes or other labor disputes shall be at the sole discretion of the party encountering the strike or dispute.

Nothing contained herein, however, shall be construed as preventing the Buyer from discontinuing the operation of the plant for such periods of time as may be required by Buyer to perform necessary overhaul operations on plant properties or to accomplish preventative maintenance operations on such plant properties, which the Buyer may determine as necessary to safeguard its investment in the plant.

16. ADJUSTMENT OF MINIMUM BILL: In the event that Seller is unable to deliver or Buyer is unable to receive gas as provided in this Contract for any reason beyond the reasonable control of the parties, or in the event of force majeure as provided in Section 15 hereof, an appropriate adjustment in the minimum purchase requirements specified in Section 7 shall be made.

IMC's contentions falling in this category are that its minimum purchase obligation under ¶ 7 of the Contract is modified by reason of: (a) force majeure; (b) circumstances and events

beyond the reasonable control of the parties; (c) frustration of purpose of object of contract (commercial frustration); (d) supervening impracticability; and (e) good faith compliance with governmental air quality regulations.

The force majeure clause in ¶ 15 delineates certain circumstances, including interference of civil authorities and any "other casualty or cause beyond the reasonable control of the parties" which, if they *prevent* performance, will excuse the parties from failure to perform the contract. The language requiring that performance be prevented by such circumstances conforms with the same requirement found in the doctrine of force majeure:

> Generally the rule is stated that, to constitute force majeure, the event must render performance absolutely impossible. This would appear to follow from the wording of the general codal provision itself which provides that the debtor may be discharged if he is *prevented* from performing by an event of force majeure . . . .
>
> In keeping with the foregoing, the fact that performance may be made considerably onerous for one of the parties by governmental acts, natural causes, or human agencies, will generally not operate to excuse such party from the required performance. (Emphasis in original).

Smith, *Impossibility of Performance as an Excuse in French Law: The Doctrine of Force Majeure*, 45 Yale L.R. 452, 454 (1936). Under this rule, the EIB regulation must have made illegal or prohibited absolutely IMC's daily purchase of 4800 million BTU's of gas. *See Wood v. Bartolino*, 48 N.M. 175, 185, 146 P.2d 883 (1944) (rule of commercial frustration applied to leases.). Though the regulation with other motivation led to IMC's selection of a process which did not require the minimum volume stated in the contract, this is not to say that the regulation prevented the minimum purchase. IMC's reliance on force majeure and related language of the contract is misplaced.

IMC next relies on ¶ 16 in support of its assertion that an adjustment in its minimum purchase obligation should be made because Regulation 508 constitutes a "reason beyond the reasonable control of the parties" causing reduced gas requirements and

thus IMC's inability to receive gas as provided in the contract. It also advances the 1975 pricing amendment as evidence of prior course of dealing between the parties in terms of their construing this paragraph. I find that IMC was not obligated to finally comply with the EIB regulation until December, 1984, well after the contract would have terminated. Also the section of regulation allowing compliance by the "salting-out" process was included at IMC's sole request. It is clear that the purpose of the added sections was to permit replacement of the Ozarks with the process using less gas. Though it is admirable that such a process results in decreased particulate emissions, it is also evident that IMC's reduced gas consumption was not mandated by any reason beyond its reasonable control. The 1975 amendment has no bearing on this issue, and did not result from any provision of ¶ 16.

Much of the testimony at trial and argument in the briefs concerns the issue of IMC's possible means of complying with Regulation 508 other than shutting down the Ozarks. Llano asserts that alternative methods of compliance with the regulation were available to IMC without its reduction of gas usage, including use of Venturi scrubbers or Brinks Mist Eliminators, with and without heat recovery systems, and a device called a Multiple Effect Evaporator. There is considerable dispute as to whether these alternative methods were technically or commercially feasible, and whether or not their use would have resulted in reduced gas requirements for the Ozarks. While it seems that IMC's decision to comply with Regulation 508 by its successful implementation of the "salting-out" process was based on its view that the other methods were not as profitable and/or technically suitable, such a finding does not help the plaintiff. This is true in spite of its reliance on the doctrines of supervening impracticability, Restatement (Second) of Contracts § 261, or commercial frustration, *id.* § 265.

The approach of the cases to the impracticability doctrine is to determine whether an unforeseen event occurred, whether the nonoccurrence of the event was a basic assumption underlying the agreement, and whether the event rendered performance commercially impracticable. *Roth Steel Products v. Sharon Steel*

Corp., 705 F.2d 134,149 (6th Cir. 1983). The party asserting the defense of commercial impracticability bears the burden of proof. The analysis is conducted with a regard for any allocation of risk provided in the agreement. *Transatlantic Financing Corp. v. U.S.*, 363 F.2d 312, 319 (D.C. Cir. 1966) (Suez Canal closing case). Finally, the unforeseeable event upon which excuse is predicated must be due to factors beyond the party's control. *Roth Steel Products v. Sharon Steel Corp.*, *supra*, at 150.

IMC began studying alternatives to the Ozarks as early as 1971. It was instrumental in drafting the 1978 regulation, and its compliance with it was substantially in advance of the deadline. A principal motive was reduction of gas consumption and expense. I cannot agree that its failure to take the minimum volume results in spite of its reasonable efforts to surmount obstacles to performance. *See Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co.*, 508 F.2d 283 (7th Cir. 1974); Restatement (Second) of Contracts § 261, comment b (1981).

The analysis under the commercial frustration rule as well as under the supervening governmental regulation doctrine upon which plaintiff also relies are essentially the same as that of impracticability. *See id.*, Comments to §§ 264 and 265. Though there is some difference in the degree that foreseeability is a factor under the three rules, the trend toward greater governmental regulation indicates allocation of such risk to the promisor. *Id.* In any event, I find that IMC has failed to affirmatively demonstrate that its alleged inability to perform was caused by Regulation 508, and thus it is not excused from performance under the Restatement rules or the general doctrine of impossibility.

IMC argues that "new technology" combined with increased gas cost is an occurrence in addition to governmental regulation that would discharge its minimum purchase obligation. This argument also is untenable. *See Thomas v. Pavletich*, 31 N.M. 76, 239 P.862 (1925). IMC pled, but has failed to brief, failure of consideration as an affirmative defense. Though it probably has abandoned this defense, I find that adequate consideration supports the contract.

Equitable Defenses

IMC contends that Llano waived, and is estopped from asserting, any claim for payment for the deficiency between the volume actually taken and IMC's minimum purchase obligation. Under its waiver theory, IMC argues that the parties' prior course of dealing constitutes a different basis of their understanding of the terms of the contract. Specifically, IMC states that Llano's voluntary delivery of natural gas in excess of the maximum volume and without written agreement shows that the figures in ¶ 6 are simply estimates of IMC's requirements. It also asserts that since Llano voiced no complaint to the reduced minimum volume taken in 1981 and 1982, it therefore is estopped from asserting existence of a deficiency volume and a claim to a minimum bill.

Paragraph 7 of the contract provides that "[f]ailure on the part of Seller to so bill [in the month of December in the calendar year in which such deficiency occurred] Buyer for any such deficiency payment shall not constitute a waiver hereof by Seller." IMC undoubtedly was aware of this language. Defendant's Exhibit C(6). Llano did not relinquish any right to its deficiency billing, and its voluntary delivery of gas in excess of the maximum does not constitute waiver nor is it estopped from asserting the deficiency volume claim to which it is entitled.

Interestingly, IMC also claims that Llano breached its duty to deal with IMC in good faith. The testimony and evidence produced at trial show that IMC never notified Llano of the reason for its reduction of gas consumption until after it received the minimum bill. On May 21, 1980, Stan Bode of IMC told Loury Greig, by telephone, that tests were to be conducted for three to four weeks with gas usage during that time being 50-60% of normal. Though in a February 11, 1982 letter denying Llano's minimum bill claim, IMC states that it notified Llano of the EIB regulation and its effect on gas consumption, there is nothing in the record to ascertain that Llano was so informed. The contract provides for notice, the importance of which was recognized in *Brown v. American Bank of Commerce*, 79 N.M. 222, 226, 441 P.2d 751 (1966).

On August 29, 1982, Mr. Bode again talked with Mr. Greig by telephone. He notified Llano that IMC was planning to remain on the reduced gas consumption for the rest of the year, and would try to give Llano at least a month's notice before raising its gas consumption. There is some confusion as to whether Llano understood whether this meant the remainder of the fiscal or calendar year, but it is certain that Llano reasonably expected that it was required, during this time, to deliver up to the maximum volume stated in the contract.

On September 19, 1980, a meeting was held in Dale Willhoit's office at which time Llano attempted to obtain IMC's approval to Llano's proposed assignment of a portion of its gas purchase contracts. This meeting was followed by a letter of September 23, 1980 from Mr. Greig to Mr. Willhoit. The letter stated that Llano needed to assign certain contracts because of an excess of contracted gas it had resulting from IMC's estimate of its future gas requirements. Dan Reddy, of IMC, did consider Llano's request, as shown by his November 19, 1980 memo to Mr. Willhoit. He also drafted a response which he testified he proposed sending to Llano because he thought that they should be notified in writing of IMC's reduced gas consumptions and the reasons therefor, as required by the contract. This draft letter, attached to a December 4, 1980 memo to Mr. Willhoit, was never mailed to Llano. In short, IMC did not indicate to Llano any estimate of future gas consumption, nor did it respond in any fashion to Llano's request for assignment as expressed in the September 23rd letter.

IMC asserts that fair dealing mandates some kind of notice or demand by Llano with respect to its minimum bill prior to January, 1982, and that Llano's failure to give such notice constitutes bad faith. IMC was fully aware of the minimum bill provision in the contract. It was IMC's silence and failure to respond to Llano's inquiry that prevented any timely resolution of the problem. IMC is liable under the contract for payment of the minimum bill.

III.
DAMAGES

The parties have stipulated that all of the natural gas purchased by Llano from wellheads in 1981 or the first half of 1982 that could have serviced the IMC/Llano contract was either consumed and paid for by IMC, consumed by Llano for its own operations, sold to rigs at a price equal to or greater than IMC would have paid had it taken the gas, banked under a wellhead banking agreement, or placed by Llano into a storage facility owned by Llano. IMC claims a set-off for the price of the gas that Llano has sold to other parties, and asserts that Llano has a duty to mitigate its damages by selling the gas elsewhere.

The parties bargained at arm's length. They have dealt with each other for twenty years. They were free to reach any agreement suitable to them. Their intentions are easily ascertainable, and the terms of the contract are clear. No question as to the meaning of the minimum purchase obligation was raised until IMC changed its method of drying. The contract does not indicate that Llano has any duty to account for any gas it sold to others. Rather, it plainly imposes upon IMC an obligation to take or pay for minimum volumes. Any contrary intent could have easily been specified. Llano is entitled to all amounts due for minimum bills for the contract term.

The parties, in the stipulation, outlined their respective positions on the proper measure of the minimum bills. Their disputes concern (1) the calculation of the deficiency volume; (2) the calculation of the deficiency price; and (3) the propriety of Llano's claim for recovery of gross receipts tax.

IMC argues that its minimum purchase obligation cannot exceed Llano's maximum delivery requirements. Paragraph 6 provides that Llano's maximum daily delivery requirements shall be 133% of IMC's average daily requirements for the preceding 365 days, but never in excess of 6400 million BTU's per day. In March or April, 1981, Llano's maximum delivery requirement did drop below IMC's minimum purchase obligation of 4800 million BTU's per day. However, I find that the minimum purchase obligation is not subject to the decrease in Llano's maximum

daily delivery requirement, and remains at 4800 million BTU's per day pursuant to ¶ 7.

If IMC failed to take the minimum volume of gas (355 × 4800 million BTU's) during any calendar year, it is obligated to pay for the deficiency between the minimum volume and the volume actually taken. The parties agree that the applicable price for the deficiency is governed by the 1975 amendment to ¶ 5 of the contract. Thus, the price is "based on the Seller's Average Wellhead Cost per MMBTU plus eight cents (8¢) per MMBTU", subject to adjustments not important here. IMC objects to Llano's calculation of the deficiency price on two grounds.

Its first argument is centered on the definition of "average wellhead cost" contained in the amendment:

> Average Wellhead Cost hereunder shall mean the cost paid by Seller for gas purchased from the wellheads throughout its system including application of all adjustments. Provided, this average shall be weighted by applying the lowest priced gas first in the event gas in excess of Buyer's purchases is purchased by Seller until the volume purchased by Buyer is attained. In the event Seller owns less than one hundred percent (100%) of the gas taken by Seller from a given well then Seller's actual ownership percentage will be applied to the volume taken and that calculated volume will be used for purposes of determining Average Wellhead Cost regardless of the amount actually taken and credited by Seller for its own account.

The parties recognize that the average cost shall be weighted by applying the lowest priced gas first, the next lowest priced gas second, and so forth. IMC argues that the cost should be averaged only on the gas it actually took, where Llano calculated the price on the cost average of the minimum volume (355 × 4800). I find that Llano's calculation of the deficiency price in this regard is consistent with the minimum purchase obligation provision and the pricing amendment of the contract.

IMC also contends that the eight cent per MMBTU increment provided in the amendment is a transportation charge and should

be disallowed because the gas was not delivered. Though the 8¢ does reflect a transportation charge, the amendment makes no such reference. The 8¢ is a factor to be included in calculating the price in effect.

The 1975 amendment includes "all applicable taxes" as part of the price. However, IMC must pay gross receipts tax only for gas actually delivered. It is not obligated to pay gross receipts tax on the deficiency billing amount.

There is no provision in the contract for an award of attorney fees. Llano's claim for attorney fees is denied.

The Parties shall submit an approved judgment in accordance with this opinion.

IT IS SO ORDERED.

.....

SENIOR UNITED STATES
DISTRICT JUDGE

Supreme Court, U.S.
FILED
JAN 7 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1041

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

LLANO, INC.,

Petitioner,

v.

INTERNATIONAL MINERALS & CHEMICAL CORPORATION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether, in this diversity case involving a contract for the intrastate sale of natural gas, the court of appeals correctly construed the contract in light of New Mexico law and properly applied it to the specific facts of the case.*

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* Respondent International Minerals & Chemical Corporation has no affiliates and only two partially owned subsidiaries—Farm Service Equipment Co., and Wilson Carbon Italia S.P.A.

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals is reported at 770 F.2d 879. The opinion of the district court is not reported.

JURISDICTION

The judgment of the court of appeals was entered on August 9, 1985. A petition for rehearing was denied on September 18, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

New Mexico Stat. Ann. § 55-2-615 (1978) in pertinent part provides:

> Except so far as a seller may have assumed a greater obligation and subject to the preceding section . . . on substituted performance:
>
> > (a) delay in delivery or nondelivery in whole or in part by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency, the nonoccurrence of which was a basic assumption on which the contract was made, or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid; . . . .

STATEMENT

This diversity case involves a dispute over a contract for the intrastate sale of natural gas. Under the contract, petitioner Llano, Inc. ("Llano"), the operator of an intrastate pipeline in New Mexico, supplied natural gas to respondent International Minerals & Chemical Corporation ("IMC") for use at IMC's potash mine and processing facility near Carlsbad, New Mexico. Pet. App. A-2. The contract required IMC to pay a minimum annual bill if it did not make a minimum annual purchase of gas. *Id.* at A-3. The contract further provided, however, that the minimum bill would be adjusted "[i]n the event that . . . [IMC] is unable to receive gas as provided in this Contract for any reason beyond the reasonable control of the parties . . . ." Pet. App. A-5. The question presented here concerns the construction of this provision of the contract and its application to the particular facts of the case.

IMC needed natural gas principally to burn as fuel for nine large gas-fired boilers (known as "Ozarks") used in the extraction of potassium sulfate, or potash. Pet. App. A-5. The operation of these boilers produced a considerable amount of air pollution. *Id.* In 1978, the New Mexico Environmental Improvement Board ("EIB")

promulgated an air quality regulation ("AQR 508") requiring drastic reductions in such air pollution "as expeditiously as practicable." *Id.* at A-6. Compliance was required to be achieved in accordance with a "schedule of compliance" approved by the EIB. Pl. Ex. 20, p. 1.

After careful study and testing, IMC determined that, owing to a variety of technical constraints, it would not be able to achieve compliance with AQR 508 unless it discontinued use of the Ozarks and turned to some other method of extracting potash. Pet. App. A-6 n.1. *See also* I R. 291; III R. 247-48, 251; IV R. 456, 458-59, 471, 495, 504-14.[1] IMC concluded that its best hope of achieving compliance lay in the adoption of a new technology called the "salting out process." Pet. App. A-6 to A-7. In May, 1980, IMC sought and obtained from the EIB a schedule of compliance that provided one year within which to conduct a pilot test of the new process. *Id.* at A-7. During the test, the Ozarks were shut down and IMC's natural gas requirements were reduced by approximately 60 percent. *Id.*

The schedule of compliance provided that if, after the pilot test, the salting out "process is deemed commercially operational [IMC shall] provide supplemental compliance schedule which includes dates for the design, procurement, and construction of the process . . . by June 1, 1981." Pl. Ex. 25, p. 2. By March, 1981, it had become apparent not only that the salting out process was commercially operational but also that it had completely eliminated the air pollution previously associated with the extraction of potash and that no further design, procurement, or construction was necessary. Pl. Ex. 28; III R. 247. In accordance with the schedule of compliance, and to fulfill its duty to achieve compliance as expeditiously as practicable, IMC notified the EIB that

---

[1] "R." refers to the multi-volume record in the court of appeals.

the test had been successful and that "IMC will be able to immediately eliminate continued use of the [Ozarks] . . . ." Pet. App. A-7.[2]

As a consequence of the replacement of the Ozarks with the salting out process, IMC's purchases of natural gas from January 1, 1981, through the expiration of the contract on June 30, 1982, fell below the amount of the minimum purchase requirement specified by the contract. Pet. App. A-7. Llano was able to dispose of the gas elsewhere, however, at a higher price. *Id.* at A-7 to A-8; Pl. Exs. 47 and 48. IMC paid Llano for all gas actually delivered, but Llano demanded payment for additional gas not taken, based upon the contractual provision for a minimum annual bill. IMC refused on the ground that "the reduction in our gas consumption was necessitated entirely by the adoption and thereafter, enforcement, of a new regulation of the State of New Mexico Environmental Improvement Board directing reduction of particulate matter emissions from our [Ozarks] as expeditiously as possible." Pl. Ex. 32.

IMC then instituted this action for declaratory judgment in the United States District Court for the District of New Mexico. Llano counterclaimed for payment of the minimum bill. The district court construed the contract as requiring payment of the minimum bill unless state law "made illegal or prohibited absolutely IMC's daily purchase of 4800 million BTU's of gas." Pet. App. C-10. The court therefore ordered IMC to pay Llano approximately three and one-half million dollars. Pet. App. A-2.

The United States Court of Appeals for the Tenth Circuit reversed. The court of appeals noted, first, that

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[2] Although the salting out process entailed lower fuel costs, it was less profitable than the process it replaced because it produced less potash. IMC estimated that it lost approximately $500,000 per year as a result of its conversion from the Ozarks to the salting out process. II R. 55.

the question before it involved simply the construction of of a commercial requirements contract in the context of governing New Mexico law:

> On a fundamental level, this case is one of contract construction. Our primary objective, as always, in the construction or interpretation of a contract is to ascertain the intention of the parties. *Schultz & Lindsay Construction Co. v. State*, 494 P.2d 612, 613 (N.M. 1972); *Yankee Atomic Electric Company v. New Mexico and Arizona Land Company*, 632 F.2d 855, 858 (10th Cir. 1980) (interpreting New Mexico law). We assume that the parties intended a reasonable interpretation of the language. *Smith v. Tinley*, 674 P.2d 1123, 1125 (N.M. 1984) . . . . As we examine the language [of the contract], an appropriate area to look for guidance is the common law doctrine of impossibility/impracticability, codified at Section 2-615 of New Mexico's Uniform Commercial Code (N.M. Stat. Ann. § 55-2-615 (1978)), which was the law in New Mexico at the time the parties contracted and which remains the law today.

Pet. App. A-9.

With those precepts in mind, the court of appeals stated that "[t]he determinative question, then, is: Did the promulgation of Rule 508 constitute an event beyond the reasonable control of IMC that rendered IMC 'unable' to receive its minimum amount of gas under the contract?" Pet. App. A-11. The court determined that, "construe[ing] the term in light of the common law as it existed in New Mexico when the contract was entered into . . . 'unable' is synonymous with 'impracticable,' as that term is used in the common law and in Section 2-615." *Id.* Under New Mexico law, the defense of impracticability requires only a showing that performance involves "extreme or unreasonable difficulty, expense, injury, or loss . . . rather than that it is scientifically

impossible." *Id.* at A-12, quoting *Wood v. Bartolino*, 146 P.2d 883, 886 (N.M. 1944).

The court of appeals therefore concluded that "[i]nasmuch as there was no technically suitable way for IMC to comply with the EIB's Regulation 508 without shutting down the Ozarks and changing to the [salting out process], with the concomitant decrease in natural gas consumption, we hold that . . . IMC was unable, for reasons beyond its reasonable control, to receive its minimum purchase obligation of natural gas . . . ." Pet. App. A-13. The court rejected Llano's contention that "IMC should have stalled in its negotiations with the state regulatory agency, which would have resulted in the pollution of air until the last minute." *Id.* The court explained:

> First, as a matter of policy, individuals and corporations who cooperate with local regulatory agencies and comply with the letter and spirit of legally proper regulations, environmental or otherwise, are to be encouraged. Stalling tactics are not regarded favorably. Second, as a matter of law, government policy need not be explicitly mandatory to cause impracticability. . . . *Eastern Air Lines, Inc. v. McDonnell Douglas Corporation*, 532 F.2d 957 (5th Cir. 1976). . . .

Id.

ARGUMENT

Llano's petition for a writ of certiorari is frivolous. This diversity case does not remotely satisfy the criteria for review by this Court. *See* Sup. Ct. R. 17. It does not even present a question of federal law. The decision of the court of appeals turned solely on the specific terms of the parties' contract, which the court construed in light of New Mexico law and applied to the particular facts of the case.

Llano contends that the decision below will raise doubts about the enforceability of minimum annual purchase requirements and minimum annual bills in other contracts and under other circumstances. Pet. 4-8. That contention is insubstantial. The court of appeals did not question the assumption that New Mexico law permits enforcement of such provisions in contracts for the intrastate sale of natural gas. The court held only that, under the particular facts and circumstances of this case, payment of the minimum bill was excused in accordance with the specific provision of the contract relating to occurrences beyond the reasonable control of the parties.[3]

Llano accuses the court of appeals of improperly construing the contract and New Mexico law in a manner that may encourage early compliance with governmental regulations. Pet. 8-9. Early compliance with environmental regulations is, of course, to be encouraged and applauded. This was not, however, a case of premature compliance. Not only did AQR 508 require compliance

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[3] The Federal Energy Regulatory Commission has determined that minimum commodity bills in contracts for the *interstate* sale of natural gas are "unjust and unreasonable" as a matter of federal law, 49 Fed. Reg. 22778 (June 1, 1984), and that determination was sustained in *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985). The decision below, however, is not in conflict with that ruling and does not involve the federal question which that ruling presents.

with the new emissions standard as "expeditiously as practicable" but a second environmental regulation, AQR 705, further required IMC immediately to obtain and to operate under a schedule of compliance designed "to achieve compliance with the applicable regulations as expeditiously as practicable." Pl. Ex. 20, p. 4. Under IMC's schedule of compliance, once IMC had determined and had notified the EIB that the salting out process was commercially operational and that no additional design, procurement, or construction was necessary, IMC became barred by New Mexico law from using the Ozarks and from continuing the air pollution that they had caused. Pl. Ex. 25, p. 2. *See also* N.M. Stat. Ann. §§ 74-1-10 and 74-2-12 (1978).

Llano further complains about an alleged lack of notice. Pet. 9-11. The court of appeals agreed that IMC had not given Llano the full notice required by paragraph 15 of the contract, relating to force majeure. Pet. App. A-10. But the court's decision turned on paragraph 16 of the contract, which "affords the buyer additional protection." *Id.* at A-11. That provision contained no notice requirement. *See id.* at A-5. In any event, IMC had given Llano repeated notice that it was conducting a test of the salting out process and that its gas consumption would be substantially reduced as a result. *See* II R. 160, 162; III R. 259-60; Pl. Ex. 30; Def. Ex. C-7. This notice was adequate to permit Llano to dispose of its excess gas at a significantly greater profit than it would have received if the gas had been delivered to IMC. Pl. Exs. 47 and 48.

In summary, IMC promptly and conscientiously complied with a new state environmental regulation, and it did not cause Llano to suffer any economic loss by doing so. Especially in these circumstances, the court of appeals quite properly read the contract as excusing IMC from paying "for any natural gas it did not take under the contract." Pet. App. A-13.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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